NO. 2773

In the United States Circuit Court of Appeals

For the Ninth Circuit

MAINE NORTHWESTERN DEVELOPMENT COMPANY, a Corporation,

Appellant,

vs.

NORTHWESTERN COMMERCIAL COMPANY, a Corporation,

Appellee.

APPELLEE'S REPLY BRIEF ON MOTION TO DISMISS.

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I.

(a) Among the cases cited by appellant is that of *American Sign Co. v. Electro etc. Sign Co.,* 211 Fed. 196, wherein Judge Van Fleet held that the rule applied in *Hartshorn v. Day,* 19 How. 211, and *George v. Tate,* 102 U. S. 564, was applicable only to actions at law upon sealed instruments.

We have assumed that the decision in *Hill v. N. P. Ry. Co.,* 113 Fed. 914, and *Standard Portland Cement Corporation v. Evans,* 205 Fed. 1, committed this Court to the doctrine that the same rule applied in actions at law upon unsealed instruments.

Assuming, therefore, that the defense of fraud in inducing the execution of an instrument is an equitable defense under the rulings of this Court in the cases cited, the rule has no application to the facts pleaded in this case.

In the *Portland Cement* case, this Court used the following language in defining what defenses based upon fraud are legal and what are equitable within this rule:

"The facts alleged do not show that the notes were not executed by the corporation, or that the execution thereof was procured by any trick or fraud so as to render them void, and thus present a defense that might be made under a plea of *non est factum.* They show that the notes were executed understandingly and intentionally, but that the assent of the plaintiff-in-error to the execution of the same was procured by fraud and deceit, and that the action of one of the officers of plaintiff-in-error was influenced by fraudulent motives."

In the case at bar, the facts pleaded *do* show that the instrument sued on was not executed by appellee nor assented to by it, and that the appellee, immediately upon ascertaining that such an instrument had been executed in its name by Rosene, repudiated it and gave

notice thereof to the appellant. The defense further shows, as a part of the related facts and in explanation of the signature, that the appellee's name was signed to the instrument by Rosene without its authority, and that Rosene was procured to sign the name of the appellee to the instrument by the promise and agreement of appellant to buy his mining property and pay over to him any collections appellant might make from appellee on this instrument. This defense comes squarely within the first statement of the rule as given by this court in the above quotation. All of the facts pleaded could have been proven under a plea of *non est factum* at common law. Under the system of pleading prevailing in the State of Washington, however, there is no such plea as *non est factum,* and the pleader is required to state the facts constituting the defense.

In its last analysis, the defense referred to is in substance that the instrument was never executed by the appellee, nor by its authority, nor assented to by it, but was promptly repudiated by it; that its name was signed thereto by Rosene, its president, without its authority, and that Rosene was adversely interested at the time and signed the appellee's name to the contract pursuant to the agreements and understandings between Rosene and the appellant set out in the plea. The plea would have been good and sufficient without any recital of the facts which induced

Rosene to sign the name of the appellee to the instrument.

The fact that the defense, after alleging that Rosene had no authority to execute the instrument on behalf of the appellee, also alleges that Rosene was disqualified by reason of his adverse interest from acting as the agent of the appellee in this matter does not convert the defense from a legal to an equitable one. Whether the plea is double or not is immaterial on this issue.

All of the facts pleaded go to show that at the time this action was instituted there was no legal contract in existence. The contract was never authorized by the appellee, and was never executed by anyone authorized to act for the appellee, and was repudiated by the appellee; its name was signed thereto by one who was both unauthorized and disqualified to act on its behalf. It is not a case of the execution of a contract understandingly and intentionally by the appellee under the influence of fraudulent misrepresentations; but, on the contrary, is a case where no contract ever came into existence, because the instrument was never executed by anyone authorized to contract for the appellee.

(b) The appellee further contends that the fifth affirmative defense is also equitable (page 19, Brief). The contract sued on was an alleged subscription to

the preferred shares of appellant's stock. The subscription agreement provided that each subscriber to preferred stock should, upon payment, receive as a bonus an equal amount of common stock (Record, p. 22). That was a material part of the contract of subscription, and it was necessary for plaintiff to show a readiness and ability to perform this part of the contract, as a pre-requisite to recovery against the defendant. The amended complaint alleges that the capital stock of the company consisted of $2,500,000 of preferred stock of the par value of $5 per share, and $3,750,000 of common stock of the par value of $5 per share; that the corporation purchased from Rosene 171 mining claims and water rights in Alaska, and agreed to pay therefor $3,995,000, consisting of $245,000 in cash, and $3,750,000, par value of fully paid non-assessable shares of the common stock, being the full amount of the common stock; that the mining claims and water rights were, in the judgment of the appellant's directors, necessary for its business, and that said sum of $3,995,000 was "in the honest and bona fide judgment of plaintiff's directors the fair and reasonable value of said mining claims and water rights."

It further alleges that after this common stock had been, in good faith, issued to Rosene in payment for the mining property, he deposited 499,989 shares thereof with A. A. Hauseman & Co., to be issued as

a bonus to subscribers to the preferred stock under the terms of the subscription agreement. These allegations were intended to show that plaintiff was possessed of the necessary number of common shares to enable it to perform its part of the agreement with all subscribers to preferred stock, and that such common shares had been already paid for in property and were therefore free from liability to assessments under the Maine laws.

The fifth affirmative defense is in effect merely a traverse of the allegations of the amended complaint in this respect. The defense sets out the Maine statute, Section 87 of which provides that:

> "The capital stock subscribed for any corporation is declared to be and stands for the security of all creditors thereof; and no payment upon any subscription to or agreement for the capital stock of any corporation shall be deemed a payment within the purview of this chapter, unless bona fide made in cash, or in some other matter or thing at a bona fide and fair valuation thereof."

The defense then shows that this common stock had not been paid in cash, nor in any other thing at a bona fide valuation. To that end the defense alleges that prior to the organization of the appellant company, the owners of the mining property, that is, Rosene and his associates, agreed to sell the mining property to the corporation to be organized for $245,000. That Rosene and certain other associates, chiefly

A. A. Hauseman, promoted the appellant corporation and as a means to enable them to get bonus stock in the corporation contrary to the Maine statute, devised the scheme of having the mine owners place the entire title in Rosene, who would then convey the property to the appellant corporation for the ostensible consideration of $3,995,000, consisting of $245,000 cash and $3,750,000 common stock, it being distinctly understood and agreed that the real consideration for the property was $245,000 in cash, and that the common stock so pretended to be issued as a part of the purchase price of the mining property was not to be issued or delivered to the owners of the mining property, but that $1,250,000 thereof was to be divided between Rosene, Hauseman and French, the promoters of appellant, and the other $2,500,000 was to be issued as a bonus to subscribers to preferred stock. The plea further alleges that the mining property was not worth to exceed the $245,000 cash which was paid therefor; that the directors of the appellant corporation never in good faith valued it at any sum in excess of that amount; and that the shares of common stock issued ostensibly as part of the purchase price of the mining stock were never intended by the directors of the corporation, or any parties connected with the transaction, as a payment on the mining property.

The whole purpose and object of this fifth defense was to show that the payment for this common stock

was not made either in cash or property "at a bona fide and fair valuation thereof," so as to free its holder from liability to creditors, and that therefore appellant was not in a position where it could issue to this appellee shares of fully paid non-assessable common stock in accordance with the terms of the subscription agreement; and it being unable to perform the contract on its own part, it was not entitled to enforce performance against this appellee.

The defense is identically the same as that made in the case of *Trent Import Co. v. Wheelwright,* 84 Atl. 545, where the Court held that this defense was legal, and not equitable.

With respect to both of these defenses, a fair test as to whether they are legal or equitable would be—Would a bill in equity lie in aid of the defense at law? If a bill in equity had been filed by the defendant, alleging—as is done in the first defense—that the subscription contract was never executed by defendant, nor assented to by it, but was signed by its president without authority from defendant and in furtherance of his own personal interests adverse to defendant; that plaintiff had full knowledge of these facts when it accepted the contract; and that defendant gave plaintiff timely notice that it repudiated the contract: The court would have dismissed the bill for the very obvious reason that, as defendant had never executed

the contract, it needed no equitable relief. As to the fifth defense, if the plaintiff is unable to deliver to defendant full-paid common stock, in compliance with the contract sued on, no aid of a court of equity is required to enable the defendant to avail itself of that defense.

We respectfully submit that neither the first nor fifth defenses are equitable defenses, and therefore that this Court has no jurisdiction to review the case by appeal.

Respectfully submitted,

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